SLAUGHTER AND MAY/

PENSIONS ESSENTIALS

April 2024

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FUNDING

The Pensions Regulator has issued its annual funding statement which is primarily aimed at schemes with valuation dates between September 2023 and September 2024 but other trustees should be generally aware of what it says. The focus of the statement is on endgames for those schemes that are sufficiently well funded.

This statement is aimed at trustees and sponsors with valuation dates between 22 September 2023 and 21 September 2024 and other trustees should have regard to it where relevant.

The Regulator acknowledges that many schemes may currently be in a strong funding position and that as a result, they may be facing calls from employers to reduce or suspend contributions, as well as from members for discretionary increases. The Regulator does not favour a particular approach but says that "*trustees should look at their overall position, the resilience of their investment strategy to future financial market movements, and the level of covenant support… and whether their scheme has a history of paying discretionary increases*".

Trustees should also be aware that uncertainty over interest and inflation rates and a high level of geopolitical instability could impact both investments and the employer covenant. They should also allow for the potential impact of climate change and wider sustainability issues when considering long-term covenant, investment and funding strategies.

The statement has specific pointers for schemes in three different funding categories:

- **Above buy-out:** Around 50% of schemes are anticipated to have a surplus on a buy-out basis. Trustees should consider their long-term strategy and whether it remains appropriate and document whether they are intending to buy-out or run-on and explain why it is in the best interest of members. Where trustees decide to run-on, they should ensure that it is a better option for members and understand the risks involved in doing so.
- **Between technical provisions and buy-out:** Trustees should review their long-term objective and the timescale for reaching it. If they haven't agreed a long-term funding target yet, they should do so as a priority. Schemes may consider the emerging options such as consolidators, capital-backed journey plans, and the possibility of a public sector consolidator. The Regulator expects such options to be explored and whether they would be in members' interests. However, it may be reasonable for trustees to take a 'wait and see' approach, given the immaturity of these options. The Regulator intends to publish guidance on DB consolidation later this year.
- **In deficit:** Fewer than 25% of schemes are expected to be in deficit on a technical provisions basis. Trustees will need to continue to focus on achieving a recovery plan that is "*as short as reasonable, based on the employer's affordability*" and pay careful attention to employer covenant, given their higher reliance on it. Further covenant guidance is due later this year.

The annual funding statement deals with the last tranche of valuations before trustees will have to comply with the new funding and investment strategy regulations which came into force on 6 April 2024 and which will require trustees to have a funding and investment strategy focussing on the long term journey plan of the scheme. The strategy will need to be documented in a formal statement and submitted to the Regulator (see last month's Pensions Essentials for the consultation on the format of the statement).

Practical points:

- *Consider whether scheme is in valuation tranche covered by statement.*
- *Consider what an appropriate journey plan and objective for scheme is, having regard to the statement.*

ABOLITION OF THE LIFETIME ALLOWANCE

The lifetime allowance was abolished with effect from 6 April 2024 and replaced with two new allowances in relation to tax free lump sums payable in respect of a member. Some tidying up by HMRC is still expected.

By way of reminder, the key changes that have been made are:

- Benefits no longer have to be tested against the lifetime allowance and no tests have to be carried out at age 75.
- There is a new "**lump sum allowance**" which imposes a fixed cumulative limit of £268,275 on the tax-free cash that can be paid to a member as pension commencement lump sums, the tax-free part of uncrystallised funds pension lump sums or stand-alone lump sums. Serious ill-health lump sums, trivial commutation and other small lump sum benefits are not tested against this allowance.
- There is also a new "**lump sum and death benefit allowance**" which imposes a fixed cumulative limit of £1,073,100 on the tax-free elements of lump sums that can be paid in life and death, to or in respect of an individual. In addition to the amounts covered by the lump sum allowance, it also includes the tax-free elements of serious ill-health lump sums and most lump sum death benefits.

For more details on how benefits (including those paid prior to 6 April 2024) use up the new allowances and the information that will need to be given to both HMRC and individuals, see our briefing setting out the new lump sum allowances in more detail.

HMRC have said that not all of the detail is currently accurately set out in legislation and further minor technical changes still need to be made. Watch out for additional guidance from them too.

***Practical points*:**

- *Scheme administrators should ensure that they are aware of the changes to date.*
- *Trustees should ensure that administrators are properly implementing the requirements in relation to the new lump sum limits.*

CLIMATE CHANGE

The Pensions Regulator has analysed a selection of climate change reports published by trustees and published its findings. The Regulator provides examples of good practice and issues it has observed along with recommendations on ways in which trustees can improve future reports.

Since 2022, schemes with more than £1 billion in assets under management and master trusts have been required to publish climate reports. The Regulator has analysed a selection of reports and published its findings to help raise standards. Schemes not in-scope of the climate change requirements are encouraged to read the report to help them in their strategic decision making.

The review says that over 60% of schemes in the selection reviewed had some form of net zero goal with a target date of 2050 or earlier and whilst there is no requirement for such targets, the Regulator says that they can be consistent with sensible risk management.

The Regulator says it has observed some good practice on scenario analysis but has also seen areas of concern. It goes on to suggest ways in which future reports could be improved by trustees. These include:

- **Context:** Contextual information, such as scheme size, structure and popular default funds, early in the report is helpful for readers.
- **Materiality:** Where reports refer to specific investment mandates, explaining their size in relation to total assets helps readers understand an issue's materiality.
- **Generic wording:** Including specifics where possible could improve reports.
- **Developments:** Reusing parts of previous reports can be sensible but should be supplemented with a summary of developments and activities during the year.
- **Length:** The quality of reports did not necessarily correlate with their length. They varied in length, with an average of 38 pages but up to 94 pages.
- **Action plans:** Where trustees use the reporting process to identify additional work, they should set a plan, monitor and update on progress in their next report.

The Regulator also suggested points trustees could discuss with their advisers, including latest market developments and whether any developments mean appropriate scenario analysis should be re-run.

***Practical points*:**

- *Consider whether net zero targets might be appropriate.*
- *Review Regulator recommendations when preparing climate change reports.*

RECOUPMENT OF OVERPAYMENTS

The Pensions Ombudsman has issued a determination setting out his approach to determining whether trustees can properly recoup overpayments from pensions in payment, the factors he will take into account and when it might not be equitable for them to do so.

In 2019, the Court of Appeal held that increases to pre-1997 pension, paid since 1992, were not permitted under the rules of the BIC UK Pension Scheme as the relevant amendment had not been properly made. This meant that members had been overpaid pension increases, in some cases for 25 years. This latest Ombudsman determination concerned an overpayment from the Scheme to E of £91,000 over a period of 24 years.

Up to 2013, E received letters from the Scheme setting out the annual increase that would be paid to him and that it had been calculated in accordance with the Scheme rules. Those letters did not contain any additional caveats. In 2013 he was notified that problems with the increases had been identified and future increases would be suspended until the issue had been resolved. Accrued increases continued to be paid.

The Ombudsman considered whether the trustees could recover the overpayment. In determining this, he concluded he could consider whether it was fair to allow recoupment at all, which meant considering whether it was equitable to permit a change of position or estoppel defence to recovery.

In relation to a change of position defence, the factors to consider were:

- **Good faith:** Did the member know or ought they to have known that they were being overpaid?
- **Detriment:** Had the member's circumstances changed to their detriment as a result of the overpayment? This generally means that the overpayment has been spent in a way that cannot be reversed. This could include general household expenses or an increased standard of living.
- **Causation:** Was there a causal link between the change of position and the overpayment such that the member would not otherwise have acted in the way that they did?

In this case, it was clear up to 2013 that E was acting in good faith and had increased his standard of living as a result of the overpayment and that this spending was irreversible. Bank statements were not available for the full period of the overpayment, but the Ombudsman said he could still form a view on causation based on E's likely expenditure patterns from looking at later evidence. It was clear that E lived within his means and would not have spent money that he did not have.

In relation to the period after 2013, the trustees did not make it sufficiently clear to E that overpayments were continuing to build up in relation to past increases. As a result, E also acted in good faith in relation to payments received after 2013 and this continued to be the case until 2019 when the result of the Court of Appeal decision was notified to members.

The Ombudsman also considered whether it would be equitable to allow recoupment by reference to the principles of estoppel. This meant considering whether:

- there was a clear representation to E on which it was reasonably foreseeable he would rely;
- E had acted reasonably in reliance on the representation; and
- E would suffer detriment if the representation was not held to.

The payslips E received prior to 2013 amounted to a clear representation and it was reasonably foreseeable he would spend his pension. He had done so in increasing his standard of living and would suffer detriment if the increases were now repayable. However, from 2013 onwards, there was no sufficiently clear representation from the trustees that he was entitled to the increases.

The Ombudsman also considered the defence of laches - where someone has delayed so long in exercising a right to recovery that it would no longer be equitable to allow them to do so. He concluded that a delay without knowledge of the problem could not give rise to the defence. However, the trustees knew that there was a potential issue in 2011 and the Ombudsman thought that the matter could have been resolved much earlier if the trustees had used appropriate diligence. He concluded it was unconscionable to allow the trustees to pursue their right of recovery in respect of the period after the 2013 announcement up to the Court of Appeal decision in 2019.

Out of the £91,000 overpaid, the Ombudsman determined that the trustees could seek recoupment of £6,500 at a rate of £200 per month.

Practical points:

- *Ensure any communications with members about overpayments are clear and explain exactly what amounts the scheme may potentially seek to recover.*
- *Consider prompt action to recover overpayments and avoid unnecessary delays.*

CORPORATE TRANSPARENCY

The Economic Crime and Corporate Transparency Act 2023 includes a number of measures to improve corporate transparency which will apply to sponsors and corporate trustees. These include new requirements to verify the identity of all directors and People with Significant Control of both new and existing companies, registered offices and the use of corporate directors. Some of these changes have now been brought into force.

Regulations came into force in March which implement some of the new corporate transparency requirements. These include:

- A requirement for a company's registered office to be "an appropriate address". This means that if something is delivered there, it would be expected to come to the attention of the company, and that if acknowledgement of delivery is required, there will be someone there capable of giving it. This means that companies cannot use a PO box as a registered office address.
- A requirement for a company to have a registered email address where "*in the ordinary course of events, emails sent to it by the registrar would be expected to come to the attention of a person acting on behalf of the*

company". Existing companies will need to provide an email address to the registrar in their next confirmation statement and Companies House will use this email address to communicate with the company.

These requirements will apply to corporate trustees and sponsors alike.

Practical points:

- *Corporate trustees should be aware of these new requirements.*
- *Where required, ensure that there is an appropriate postal and email address and that they are notified to the registrar as required.*

DC SCHEMES

DWP has issued guidance on how trustees of DC schemes should provide information to the pensions dashboards on what the current value of a member's DC pot would provide by way of an annual income.

The value data that trustees will need to make available to members with DC benefits via the dashboards includes "*an annualised accrued value [of their DC pot], prepared using the methodology set out in the relevant guidance, less the elements regarding future contributions and growth, and calculated as if the individual has reached their retirement date on the illustration date*". The guidance sets out how that value should be calculated.

DC trustees currently have to provide members with an annual illustration of the income that their DC pot could provide for them at their projected retirement date but do not currently have to provide information about the benefits that the current DC pot could secure. These new illustrations will need to be calculated broadly in line with the existing projections and using the same assumptions.

Practical points:

- *Ensure work to be dashboard compliant is ongoing and on track.*
- *Ensure this information will be available when the scheme connects to the dashboards.*

WATCH LIST

For upcoming developments see our new pensions horizon scanning webpage.

No	Topic	Effective date or expected effective date	Further information/action
1	Changes to DC scheme governance and disclosure	Later in 2024.	Consultation expected on phased introduction of new value for money framework for all DC schemes (excepting some small schemes). Draft regulations to extend CDC to multi-employer schemes expected in 2024. Proposals on consolidators for small DC deferred pots expected late 2024, a taskforce has been set up.
2	DB consolidation	Legislation "as soon as Parliamentary time allows", for new compulsory framework for superfunds.	TPR updated interim guidance - issued August 2023.

No	Topic	Effective date or expected effective date	Further information/action
		Public consolidator to be established by 2026, consultation on features closed on 19 April 2024.	Consultation is ongoing on PPF becoming a public consolidator and the conditions that should attach to its operation as such.
3	Changes to pensions tax allowances	Lifetime allowance removed on 6 April 2024 and two new tax-free cash allowances introduced.	Further amending Regulations expected in 2024/25.
4	Repayment of surplus	The reduction in the tax charge took effect on 6 April 2024. Current consultation closed on 19 April 2024.	Tax charge on repaying surplus reduced from 35% to 25%. Consultation underway on facilitating repayment of surplus in ongoing schemes and appropriate safeguards for members.
5	Funding and investment strategy requirements for DB schemes	Legislation came into force 6 April 2024. Funding and investment strategy in place 15 months from date of the first valuation obtained on or after 22 September 2024. Revised Code of Practice from TPR expected to be published Q2 2024.	Consultation on covenant guidance expected in 2024. TPR has issued a consultation on the form of the strategy statement.
6	Notifiable events for DB schemes on corporate and financing activity	Significant uncertainty about publication of Government response to consultation on draft Notifiable Events (Amendment) Regulations.	TPR will consult on update to Code of Practice 2 (Notifiable Events) and accompanying guidance once DWP have published their finalised regulations and consultation response.
7	Pensions dashboards	Compulsory connection deadline of 31 October 2026 for schemes with 100 or more active and/or deferred members at year end between 1 April 2023 and 31 March 2024; staging timetable set out in DWP guidance. Application for deferral (in limited circumstances existing at 9 August 2023) must be made by 8 August 2024.	All registerable UK-based schemes with active and/or deferred members.

No	Topic	Effective date or expected effective date	Further information/action
8	Corporate transparency	The Economic Crime and Corporate Transparency Act 2023 introduces requirements on identity verification, corporate directors and limited partnerships. The requirement to have a registered email address and for registered offices to meet certain requirements came into force on 4 March 2024. Other provisions are due to come into force later in 2024.	All corporate trustees and schemes using Scottish Limited Partnerships. More detail about what the Act requires can be found in our briefing.

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